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**The Climate Trust Comments to the California Market Advisory Committee
on *Recommendations for Designing a Greenhouse Gas Cap-and-Trade System
for California***

Thank you for providing The Climate Trust with the opportunity to submit comments to the Market Advisory Committee (MAC) on its report *Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California*. We commend California and the Market Advisory Committee for their pioneering lead in the development of comprehensive greenhouse gas emission reduction policies under Assembly Bill 32.

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The mission of The Climate Trust, a non-profit organization, is to provide climate change solutions by purchasing high quality greenhouse gas (GHG) offsets from projects that reduce greenhouse gas emissions, and advancing sound offset policy. The Climate Trust's principal role is to purchase offsets on behalf of entities interested in mitigating their greenhouse gas emissions through the implementation of projects that lead to verifiable reductions of greenhouse gas levels in the atmosphere. As one of the largest purchasers of offsets in the U.S., The Climate Trust has \$8.9 million invested in a diverse portfolio of 17 offset projects, accounting for 2.7 million metric tons of greenhouse gas reductions.

Mike Burnett,
Executive Director

Introduction

The Climate Trust commends the members of the Market Advisory Committee for a thoughtful and comprehensive set of recommendations. Our comments focus specifically on the recommendations of the MAC regarding the integration of greenhouse gas (GHG) offsets under AB 32.

Overall, The Climate Trust supports the recommendations of the MAC regarding GHG offsets and their integration into future policy, particularly the call for high quality standards and rigorous accounting procedures. The Climate Trust would like to submit additional comments on the following three points:

- 1. The use of standards-based approaches for offset quantification and allowed offset project types and standards.**
- 2. The stimulation of additional emissions reductions through the use of auction revenues.**
- 3. The incorporation of new offset projects under AB 32.**

Standard-based Quantification and Allowed Offset Types

The opportunity for regulated entities to take advantage of reductions with the lowest marginal cost first is one of the primary benefits of including offsets in a cap-and-trade system. Limiting the types of offset projects eligible for use under future regulation will constrain supply and increase demand for those project types, thereby driving up price. The Climate Trust encourages the inclusion of additional offset project types as quickly as practicable.

There are two primary methods used to evaluate a greenhouse gas reduction project: 1) project-specific assessments and 2) standard-based assessments. Project-specific assessments are individual or case-by-case examinations of the unique circumstances of a proposed GHG project.

In a project-specific assessment a project's emission's levels are evaluated against a unique emissions baseline, which is the amount of greenhouse gases that would be emitted in the absence of the project, most commonly the amount emitted before the project is implemented. In a project-specific offset assessment, the emissions baseline is only valid for that particular project.

The standard-based approach to offset project evaluation involves identifying and establishing a universal standard for a particular offset project type. Standards-based approaches provide a prescribed quantification methodology for determining a project's baseline. In essence, by identifying a project type or sector as an eligible offset under a regulatory standard that project type or sector is deemed to be additional as long as certain criteria are met. These criteria range from a set level of market penetration certain standard of efficiency, among others.

Each approach to project evaluation has its respective strengths and weaknesses. Standards-based offset quantification offers a number of benefits under a regulatory regime including predictability, transparency, and standardization. However, standards-based methodologies can also potentially allow some projects that are not actually additional into the offset market, thereby compromising the environmental benefits of a GHG reduction program. Project-specific assessments allow for greater accuracy and reliability in assuring additional reductions in GHG levels, but this approach can be time and labor intensive and reduce the flow of projects into the market.

One way to address the challenge of crafting comprehensive standards relatively quickly would be for California to pioneer a “project-to-protocol” approach. California could designate a key state agency or non-profit organization to review offset projects on a project-by-project basis for a set period of time and use those projects as the basis for the development of offset quantification standards, which would then serve as protocols for those project types.

The Climate Trust’s experience as the key implementer of the Oregon Carbon Dioxide Standard has illustrated the complexity of the offset quantification process and the value of basing offset protocol on “real world” projects. Moreover, this approach would be more responsive to what the market has to offer and would be able to capture and incorporate technological innovation quickly and efficiently. This approach would allow new offset sectors and project types to be added on an ongoing basis, thereby allowing for innovative and new offset project types. It would also help control the cost of offsets by offering an expanding supply of offset credits and eligible project types.

Additionally, if California chooses to link with other trading systems, namely RGGI and the CDM and JI programs, this issue of variable standards will need to be addressed. RGGI has developed quantification methodologies for its six approved offset types, while CDM has 100 approved offset methodologies. For at least two project types, agricultural methane digesters and afforestation, RGGI, CCAR and CDM all have distinct quantification methodologies. This could lead to variable amounts of tons being credited from the same project, depending on which quantification methodology is used. The amount of offsets derived from any given project has important implications for project financing and feasibility. Thus, California will be asked to make important policy decisions as it determines which offset methodologies to allow under any future cap and trade system. The range and types of offset quantification methodologies will have significant implications for offset trading and fungibility between markets and systems.

A Public Greenhouse Gas Reduction Fund

Another means of stimulating greenhouse gas reducing activities in addition to the inclusion of offsets, could be through the establishment of a greenhouse gas reduction fund. Revenues generated from the auctioning of emissions allowances could be placed in a fund dedicated to financing greenhouse gas reduction projects in sectors not amenable to or not yet covered by a cap.

This fund could be structured to provide both subsidization and low-interest capitalization of greenhouse gas reducing activities across the economy. A low-cost financing mechanism, such as a low-interest revolving loan fund, would allow many GHG reduction opportunities to be realized while preserving and growing the public’s principle. The greenhouse gas reductions resulting from funding provided by

such a fund would be permanently retired on behalf of the public. Particularly if California chooses a phased approach to a multi-sector cap, this fund could be targeted towards generating early reductions in sectors uncapped in the early years of the program.

This fund would:

- provide needed funding for greenhouse gas reduction activities whose benefits are primarily environmental;
- direct funding to GHG reduction projects in areas faced with environmental justice issues;
- stimulate broad technological innovation and deployment across the economy;
- create jobs;
- improve air, land and water quality;
- achieve cost savings in a variety of sectors and industries;
- help standardize and legitimize the greenhouse gas reduction market;
- aid in market transformation and speed the transition to a lower carbon economy;
- play an integral role in the project-to-protocol development process by providing a source of funding; and,
- achieve real, measurable and quantifiable reductions in greenhouse gas levels.

This fund could be administered by either a certified, independent non-profit or by an appointed government agency. This fund could also serve as an approved source for compliance offsets under regulatory systems such as RGGI, California, and the Western Regional Climate Action Initiative, or under a federal system once established. This would help address the challenge of standardization of the market and would provide a central, regulated source for greenhouse gas reduction products, offset or otherwise.

This fund would drive much needed, and largely absent, capital into stimulating the greatest reductions in the largest number of sectors and industries. In the short term, this fund could help jumpstart reductions across the economy as the necessary adaptations are made and technologies are developed and deployed over the longer term.

New Offset Projects

There are a number of benefits to incorporating new projects into California's regulatory structure, which would be disallowed according to the MAC's current recommendations. Under the Oregon Carbon Dioxide Standard, The Climate Trust only funds new projects and would like to point out a number of the benefits associated with the inclusion of new projects under a regulatory regime.

There are greenhouse gas reduction opportunities across the economy that, for a number of reasons, are not being taken advantage of today. These include high initial capital investment requirements and low rates of return, as well as a lack of capital for projects whose benefits are predominantly environmental. Moreover, traditional lending sources are unwilling to fund activities that are potentially risky and whose benefits are primarily environmental. In many instances, the offset funding that The Climate Trust's up-front payment for future offset streams has provided has been the deciding factor in whether or not a project happened.

In this emerging market, future crediting plays an important role in financing greenhouse gas reduction projects and bringing them to fruition. Signing advanced purchase agreements for emissions reductions has benefits for both the buyer and seller of the offset. Buyers are able to lock in a certain number of tons at a certain price, thereby allowing for more accurate financial planning and cost of compliance. Sellers also benefit by a committed buyer and often, the necessary investment capital to implement a project when they need it the most, at the start of the project (the proposed GHG reduction fund discussed above could help address many of these challenges by providing a low-cost source of financing for these projects).

The Climate Trust recognizes that there are challenges in incorporating new offset projects in a regulatory system, but has developed several means to overcome those challenges. Under the Oregon Carbon Dioxide Standard:

- Comprehensive and legally-binding Emissions Reduction Purchase Agreements (ERPA) are negotiated and signed for every GHG offset project The Climate Trust funds.
- The ERPA requires that project developers guarantee the provision of offsets or the return of The Climate Trust's investment dollars in the event of project under-performance.
- The Climate Trust conducts thorough due diligence on project developers and partners to ensure their ability to execute the greenhouse gas reduction project in a timely and reliable manner.
- GHG reductions from projects The Climate Trust has funded are monitored and verified annually to ensure that the expected amount of greenhouse gas reductions have occurred (with the exception of forestry-based offsets, which are monitored every five years due to the longer project life).

These provisions mitigate some of the risks associated with necessary up-front payment for future streams of offsets from projects that The Climate Trust has funded. As the market matures and regulations are developed traditional lending sources should become more willing to finance greenhouse gas reduction projects and the need for up-front payment for future offset streams will be lessened. Today, however, up-front payment is often necessary for project developers to overcome the

significant market barriers facing GHG reduction activities. The Climate Trust encourages the MAC to consider allowing project developers to secure assurance of future crediting if certain criteria are met, at the least in the early years of the cap-and-trade program. Alternatively, a low-cost source of financing, such as that provided by a public trust, could be used to promote project development in the absence of forward-crediting.